

**BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF CALIFORNIA**



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Order Instituting Investigation to Consider Policies to Achieve the Commission's Conservation Objectives for Class A Water Utilities.

Investigation 07-01-022
(Filed January 11, 2007)

In the Matter of the Application of Golden State Water Company (U 133 E) for Authority to Implement Changes in Ratesetting Mechanisms and Reallocation of Rates.

Application 06-09-006
(Filed September 6, 2006)

Application of California Water Service Company (U 60 W), a California Corporation, requesting an order from the California Public Utilities Commission Authorizing Applicant to Establish a Water Revenue Balancing Account, a Conservation Memorandum Account, and Implement Increasing Block Rates.

Application 06-10-026
(Filed October 23, 2006)

Application of Park Water Company (U 314 W) for Authority to Implement a Water Revenue Adjustment Mechanism, Increasing Block Rate Design and a Conservation Memorandum Account.

Application 06-11-009
(Filed November 20, 2006)

Application of Suburban Water Systems (U 339 W) for Authorization to Implement a Low Income Assistance Program, an Increasing Block Rate Design, and a Water Revenue Adjustment Mechanism.

Application 06-11-010
(Filed November 22, 2006)

Application of San Jose Water Company (U 168 W) for an Order Approving its Proposal to Implement the Objectives of the Water Action Plan.

Application 07-03-019
(Filed March 19, 2007)

**REPLY BRIEF OF CALIFORNIA-AMERICAN WATER COMPANY
ON PHASE 1A ISSUES**

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September 17, 2007

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**REPLY BRIEF OF CALIFORNIA-AMERICAN WATER COMPANY
ON PHASE 1A ISSUES**

I. INTRODUCTION

In accordance with Rule 13.11 of the Rules of Practice and Procedure (Rules) of the California Public Utilities Commission (Commission) and the August 3, 2007 e-mail ruling of Administrative Law Judge (ALJ) Grau setting the briefing schedule of Phase 1A in the Commission's Order Instituting Investigation 07-01-022 (Conservation OII), California-American Water Company (California American Water or Company) respectfully submits this post-hearing Reply Brief. In this Reply Brief, California American Water responds to the

Opening Brief of The Utility Reform Network, National Consumer Law Center, Latino Issues Forum and Disability Rights Advocates (August 27, 2007) (Joint Consumers Brief) and the *Opening Brief of the Consumer Federation of California* (August 27, 2007) (CFC Brief).

Both the Joint Consumers Brief and the CFC Brief advocate the Commission apply one-size-fits-all rules to all three of the applications in this proceeding. The Commission should reject such an approach. Conservation must be tailored to the circumstances in each water district. As discussed more fully below, the Commission should permit each water company to develop a conservation program that will meet the needs of its customers and address the circumstances in its own service territories.

The proposals of the Joint Consumers and the CFC do not further the Commission's goal of implementing conservation programs in an expeditious manner. The Commission should reject these proposals and adopt the settlements in this proceeding; or, in the alternate, the Commission should adopt the settlement agreements and defer consideration of these policy issues until the second phase of this OII, in which policy issues are scheduled to be addressed.

II. DISCUSSION

A. The LIRA Program

1. The Commission Should Reject the Joint Consumers' Recommendation that the Commission Adopt a Percentage Discount for Suburban's Low Income Rate Assistance Program

The Joint Consumers recommend that the Commission adopt a percentage discount for Suburban's low income rate assistance program (LIRA), rather than the flat-rate discount, as proposed in the settlement of the Division of Ratepayer Advocates (DRA) and Suburban Water Systems (Suburban).¹ California American Water recommends the Commission permit

¹ *Motion of the Division of Ratepayer Advocates and Suburban Water Systems to Approve Settlement Agreements*, (April 24, 2007) (DRA/Suburban Settlement Motion).

Suburban to determine which method better achieves the goals of its conservation program. As discussed below, flat-rate discounts offer benefits that the percentage discount does not.

The Joint Consumers prefer the percentage discount because it believes that the percentage discount is more equitable for low income families that have a large number of people in the household.² While this may be true for some low income families with very large households, most low income customers will get a greater benefit from the flat rate than the percentage rate when water usage is at 20 Ccf per month. As DRA states in its Report, “using the flat rate discount means that many low income families are likely to receive *more* than 15% off for indoor water usage. Those who use less than the full 20 units allocated to Tier 1 usage would see even higher percentage discounts under the flat rate proposal, thus conferring a greater benefit (and not penalizing) those low income customers who conserve water.”³ (Emphasis in original.)

In coupling with a tiered rate design, the incentive to conserve is thwarted when the percentage discount is used. Regardless of usage, the customer will get the same percent reduction in its bill. In fact, this may create an incentive to disregard conservation measures, especially in low income families that do not have a large number of people living in the home.⁴

To address the needs of families with large, essential water requirements, the Commission could consider, in Phase II of this proceeding, alternative methods of rate relief. For example, families that have a large number of people living in the household may be given a higher value flat-rate discount depending on the number of people living in the household. This could be done with successively larger discounts for families falling into categories of, for

² Joint Consumers Brief at 7-9.

³ *Phase I Report of the Division of Ratepayer Advocates Regarding Suburban Water Systems*, OII 07-01-022, June 29, 2007, mimeo, at 2-3 (DRA Report).

⁴ *Id.* at 2-2, 2-3.

example, one to six people, six to ten people, and more than ten people. Similarly, a customized flat-rate discount could be given to customers with proven medical needs that require greater water usage.

Moreover, for low income families, greater financial relief may come from assistance other than discounts on their water bills. High water usage may come from lack of conservation devices, such as low-flow faucets and shower heads, from leaking pipes and toilets, and inefficient appliances, especially in families with a large number of people in the household. Low income families may not have the financial resources to address these issues. A good conservation program, that can help ratepayers with these issues, may be more cost effective for these families than a monthly discount on their water bill.

2. A Percentage Discount is More Difficult to Apply Than the Fixed-Rate Discount

The Joint Consumers Brief dismisses Suburban's concerns regarding the costs associated with implementing the percentage discount.⁵ Yet, TURN's witness admitted he had not done a cost analysis to support his statements and that he was not familiar with Suburban's billing system.⁶ However, the costs associated with the percentage discount are not limited to the programming costs to update the billing system. Every time an adjustment is made to the water bill of a customer on the LIRA program, the LIRA discount will have to be recalculated and adjusted on the bill, too. Another complicating factor is the determination of when to apply the discount. Would it be applied before or after surcharges and surcredits, before or after taxes? The flat-rate discount would be less costly and less complicated to implement and administer.

⁵ Joint Consumers Brief at 14-15.

⁶ RT 91:2-28, 92:15-28 (Finkelstein/TURN).

3. The Use of 30 Ccf in the Table on Page 9 is Not Representative of the Average Customer

In an effort to show how the variance between the percentage discount and the flat-rate discount grows as water usage increases, the Joint Consumers recreated a table from DRA's testimony that shows this variance for customers with average water usage of 20 Ccf per month. The Joint Consumers' table shows the variance with customer water usage of 30 Ccf per month.⁷ At a water usage level of 20 Ccf per month, the flat-rate discount is \$1.07 greater than the percentage discount and with water usage at 30 Ccf per month, the percentage discount is \$1.67 greater than the fixed-rate discount.⁸

To diminish the insignificant difference at these two levels, the Joint Consumers Brief states that these numbers "do not take into account large household size."⁹ To the contrary, if 20 Ccf per month is average usage, then 30 Ccf is a 50% increase in usage. As the DRA Report points out, according to the Environmental Protection Agency (EPA) estimates of average indoor water usage, 20 Ccf per month would satisfy the water needs of family sizes up to 7 persons.¹⁰ Usage of 20 Ccf per month for 7 individuals calculates to over 70 gallons of water per day per person. As the family size increases, the amount of water used by each person per day decreases, so in reality, it is much more likely that less than 70 gallons per day will be used by large families, creating an even greater advantage for low income customers on a flat rate discount. Under almost all circumstances, if low income families are using water for indoor usage only, 20 Ccf per month is more than an adequate amount of water.

⁷ Joint Consumers Brief at 9.

⁸ *Id.*

⁹ *Id.*

¹⁰ DRA Report at 2-4.

4. The Most Recent Commission Decisions Adopt Flat-Rate Discounts

The Joint Consumers Brief argues that Commission precedent supports a percentage-based discount. To support this position, it identifies two decisions in which percentage-based discounts were adopted: D.02-01-034 and D. 04-08-054.¹¹ Their brief goes on to discuss other decisions in which the Commission adopted flat-rate discounts: D. 05-05-015, D. 06-10-036, and D. 06-11-053.¹² Looking at the dates of these decisions, it is apparent that the Commission has reconsidered its position on percentage-based discounts and has chosen, in the three most recent decisions, to adopt the flat-rate discount. Indeed, just last month the Commission adopted a settlement agreement between DRA and California American Water that has a flat-rate discount in California American Water's Los Angeles general rate case.¹³ Moreover, California American Water has proposed a flat-rate discount in its 2007 general rate case and has reached a settlement with DRA. As no party has objected to the flat-rate discount, California American Water expects the Commission will adopt it later this year.¹⁴

B. The Commission Should Not Impose Components From One Settlement Agreement on the Other Companies' Settlement Agreements

According to the Commission's Rules of Practice and Procedure §12.5, settlement agreements are not precedential. Nevertheless, the Joint Consumers "urge the Commission to order a specific outreach program using the Suburban/Consumer Settlement and the Disability Rights Advocate's/Suburban MOU as a template for the type of detailed outreach necessary for Park and Cal Water customers regarding the new rate design."¹⁵ Then they "urge the

¹¹ Joint Consumers Brief at 11-12.

¹² *Id.*

¹³ *Application of California-American Water Company (U210 W) for an Order Authorizing it to Increase its Rates for Water Service in its Los Angeles District*, D. 07-08-030, mimeo, at 22-23.

¹⁴ *Settlement Agreement as to Certain Issues Between the Division of Ratepayer Advocates and California-American Water Company on the Revenue Requirements – Sacramento, Larkfield, Coronado, and Village*, filed July 6, 2007, Application 07-01-036 - 039.

¹⁵ Joint Consumers Brief at 18.

Commission to require Cal Water to collect and report the types of data that Suburban and Park have agreed to gather and report.”¹⁶

Setting the non-precedential nature of settlements aside, the Commission divided the Conservation OII into phases so that the water utilities could proceed with their individual (albeit consolidated) applications in Phase I, before general policy matters, that would apply to all water companies, would be decided in Phase II.¹⁷ The Commission should consider the merits of each settlement agreement and not hoist upon the other water companies those stipulations that one water company may have determined to be appropriate for its own company and customers.

Even the Code recognizes the need to consider each company separately. Code §739.8 states, “[i]n establishing the feasibility of rate relief and conservation incentives for low-income ratepayers, the commission may take into account variations in water needs caused by geography, climate and the ability of communities to support these programs.”

The Joint Consumers recommend many changes to the existing practices of the water companies and are quick to state that the benefits are worth the costs.¹⁸ But they have produced no cost analysis relating to any of their recommendations. Indeed, TURN’s witness stated, under cross-examination, that he had done no analysis to determine what the cost of the LIRA program subsidy would be to other Suburban ratepayers.¹⁹ The individual companies are better prepared to understand the costs associated with their settlement agreements and the Commission should allow them to tailor their conservation and LIRA programs according to the specifics of their customers and service areas.

¹⁶ *Id.* at 19.

¹⁷ Assigned Commissioner’s Ruling and Scoping Memo, March 8, 2007, mimeo, at 3-6.

¹⁸ Joint Consumers Brief at 21.

¹⁹ RT 92:15-22 (Finkelstein/TURN).

C. A Uniform First Tier For All Water Companies is Unworkable

The Consumer Federation of California (CFC) recommends that the Commission set the top level of the first tier at 10 to 11 Ccf per month to provide enough water for basic human consumption and sanitary needs for a family of four.²⁰ This may be an appropriate level to set the allowance in some water districts, but it may be too high or too low for other districts. The amount of water in a tier has to consider usage, age of the residential units, average number of people living in each unit and other district-specific items. As California Water Service Company's (Cal Water's) witness testified, customers in South San Francisco have a winter mode of 5 Ccf.²¹ In order for conservation programs to be effective, they must address the essential needs of the customers in each district.

Even a company-specific first tier will not be appropriate for each district in that company's service territory. For example, California American Water and DRA have agreed, in a settlement, to different first tier allowances in each of the service areas of California American Water's Los Angeles District. This was based on the actual winter usage in each area.²² Basing the first tier on the actual average water usage in an area much better addresses the absolute needs of that area.

Conversely, these allowances would not be appropriate for other districts in California American Water's service territory. For example, in California American Water's Monterey District, the first tier is actually determined predominately by the number of full-time individuals

²⁰ CFC Brief at 20-21. In addition to this one-size-fits-all approach, CFC also recommends that the Commission consider using budget-based rates wherein each customer has a customized allowance based on its individual needs. CFC Brief at 19-20. Due to the dire conditions in the Monterey district, California American Water uses a budget-based allowance. The process is complicated and costly, and is easily manipulated for unfair gain by customers.

²¹ *Id.* 13.

²² *Motion of California-American Water Company and the Division of Ratepayer Advocates for Adoption of Settlement Agreement As to Certain Issues on the Revenue Requirements; Settlement Agreement Attached* (filed June 26, 2006), Application 06-01-005. A final decision has not issued in this proceeding as Phase II of the proceeding is ongoing.

living in the residential unit. In other words, each customer has a tier defined specifically to their needs.²³ California American Water would not propose this type of structure except in cases of dire circumstances as exist in its Monterey District, but California American Water states this circumstance to again show that the Commission must determine an allowance based on the specific needs of a particular service area, not on generalities. As discussed above, Code §739.8 (d) recognizes that the Commission “may take into account variations in water needs caused by geography, climate and the ability of communities to support these programs.”

D. Creating Block Rates For Nonresidential Customers Requires More Time

California American Water agrees with CFC’s position that nonresidential customers should have block rates.²⁴ However, such an undertaking requires much more time than it does for residential customers that have more homogeneous usage patterns. To address this issue, the Commission should adopt the settlements to implement these conservation rates for residential customers, then address this issue in Phase II of this OII. As individual water companies are able to develop these customized block rates for nonresidential customers, they can implement them, without delaying the implementation of the residential conservation rates.

E. Cost-Based Rates are Inconsistent With Policy-Driven Rates Used to Further Conservation Programs and the LIRA Program

The CFC brief contradicts itself. In one part of the brief, CFC calls for policy-based conservation rates that will “encourage customers to conserve.”²⁵ Later in the brief, CFC recommends that the Commission set rates based on current and future costs.²⁶ Further in the

²³ *Application of California-American Water Company (U 210 W) for an Order Authorizing it to Increase its Rates for Water Service in its Monterey District*, D. 06-11-050, mimeo, at 63-68.

²⁴ CFC Brief at 22.

²⁵ *Id.* at 14.

²⁶ *Id.* at 24.

brief it calls for demand-based rates.²⁷ Calling for cost-based rates in a policy-driven proceeding is illogical, at best.

Even within the umbrella of cost-based rates, CFC contradicts itself. On page 23 of its brief, CFC states that the cost of adding additional facilities should be charged to the customers creating the demand for these additional facilities. But on page 24 and 25, CFC espouses demand-based rates wherein every customer pays higher rates in summer, even if they have consistent use year-round (as might low-income customers with only indoor use).

The Commission and the Legislature have made it clear that California needs to implement conservation rates.²⁸ While it may be possible to create conservation rates that are loosely based on costs,²⁹ the main focus of this proceeding is to develop rate structures that will encourage customers to conserve water. Moreover, postponement of conservation rates until marginal cost studies could be done is not an option. California is currently experiencing drought-like conditions, it is imperative that we implement conservation rates as expediently as possible.

F. Cost Allocation Among Customer Classes Should Be Addressed in Phase II

Because the settlement agreements in this proceeding are only applied to residential customers, CFC is concerned that the benefit of the conservation efforts of residential customers will inure to the nonresidential customers that are not subject to conservation rates.³⁰ First, this is a policy issue that should be addressed in Phase II of this proceeding. Second, if the rates are designed properly and the pre-conservation rate revenue generated by customer class is the same

²⁷ *Id.* at 24-25.

²⁸ *Order Instituting Investigation to Consider Policies to Achieve the Commission's Conservation Objectives for Class A Water Utilities*, Investigation 07-01-022, issued March 8, 2007; Code §739.8.

²⁹ The CFC brief refers to cost-based rates of the Los Angeles Department of Water and Power (LADWP). Because LADWP was not available for discovery and cross-examination, we do not have information regarding the expense and time necessary to develop marginal cost pricing. This notwithstanding, it is safe to assume that LADWP has more resources and expertise to develop marginal cost pricing than many of the water companies in California.

³⁰ CFC Brief at 25-27.

as the post-conservation rate revenue generated by customer class, then this point is mute. As long as the revenue requirement by class remains constant under any rate design, there will be no revenue or rate affects across customer classes. Some other aspects to consider include the impact of increased rates on commercial and industrial users. In a non-regulated market, increased costs are often passed on to the consumer. If water rates are increased for a local market or retailer, will those increased costs be passed on to the consumers in that community? Further, the Commission must consider the business climate in the state. It is a well-established tenet that new industry will select the most business-friendly states in which to do business. This could have a significant impact on the labor market in a given community. These issues are appropriate for further discussion in Phase II of this proceeding.

G. The Monterey WRAM Does Not Address the Reduction in Sales Due To Conservation

The CFC recommends that the Commission “[a]llow a utility to implement a ‘Monterey-style’ WRAM if a utility demonstrates that it has an incentive to promote water sales.”³¹ This statement belies CFC’s understanding of how the different types of WRAM function. The Monterey-style WRAM was never intended to protect California American Water from the effect of increased conservation. It was implemented to track revenue variations between the standard rate design and the conservation rate design based on actual consumption.³² Therefore, a water company’s incentive to promote water sales is irrelevant to a Monterey-style WRAM.

The Monterey WRAM was implemented solely to protect the company against unknown revenue variations when it was forced to move to a highly inverted, tiered rate design based on each customer’s water needs (individuals living in the house, lot size and other factors). It was impossible to determine the level of revenue that would be generated under the new billing

³¹ CFC Brief at 4.

³² RT 133:23-28, 134:1 (Jackson/Park Water Company).

structure since there was no consumption history under this new rate design. The rate design was implemented after the district was already functioning under a mandatory conservation mode. The new rate design and WRAM were implemented to maintain the already high level of conservation and to force high water users to either reduce their water consumption or pay exceedingly high rates, and allow the customers with very low usage the ability to use a little more at no additional cost - if they so desired. Further conservation effects due to the implementation of the rate design were not expected.³³ This has proven out over the years wherein the rate design has changed and rates have increased considerably, but total consumption has remained relatively unchanged. Because total consumption has not decreased significantly as a result of the implementation of conservation rate design, the Monterey district did not require a decoupling mechanism to recover its cost of service. California American Water does not believe that the Monterey-style WRAM should ever be considered the proper protection mechanism when conservation rates and plans are implemented with the expectation that water consumption will decrease. The Monterey-style WRAM was never intended to provide protection from any type of decreased consumption.

H. A Decoupling WRAM Combined With a Modified Cost Balancing Account Benefits Customers

To support its position that a decoupling WRAM may not be necessary for any of the applications in this proceeding, CFC states that “decoupling is necessary only if the utility actually has an incentive to sell more water because selling more [water] means getting more revenue.”³⁴ While this is an accurate statement, in practicality, a water company almost always has an incentive to sell more water if it wants to make more money. The water industry is very

³³ *Application of California-American Water Company (U 210 W) for an Order Authorizing it to Increase its Rates for Water Service in its Monterey District*, D. 96-12-005.

³⁴ CFC Brief at 29.

capital intensive,³⁵ so the majority of costs are fixed costs, which means variable costs are relatively low. As a result, the cost to produce incremental amounts of water is typically lower than the price customers will have to pay for it.

Because of this, decoupling mechanisms were developed to take that incentive away from water companies so that they would have no objection to implementing conservation programs and rate designs that would reduce consumption, and thereby, their ability to recover their costs of service.

Based on the statements in its brief, CFC fails to grasp the intent of the Modified Cost Balancing Account (MCBA).³⁶ While a decoupling WRAM is designed to protect the utility from decreased sales, it is not designed to capture any decreased costs. Essentially, the WRAM protects the utility. The opposite is true of a MCBA. As sales are reduced as a result of conservation efforts, the costs of production are reduced also. In any district with varying costs of water production, a MCBA is essential to capture the reduced production costs that are usually much higher at the marginal level (the level effected by conservation efforts). Without the MCBA, the differential between the average cost of water production embedded in rates and the actual higher marginal cost of production that is saved when sales are reduced, would create a benefit that would inure to the utilities. The MCBA is designed to work in conjunction with the decoupling WRAM to offset the balance in the WRAM with the savings in production costs, to the benefit of the ratepayers. When the decoupling WRAM and the MCBA are implemented in conjunction with one another, both the utilities and the ratepayers benefit.³⁷

³⁵ RT 69:5 (Kelly/Suburban).

³⁶ CFC Brief at 32.

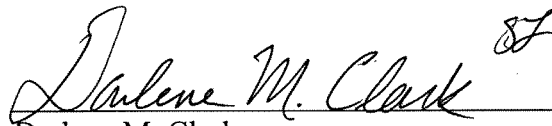
³⁷ See Cal Water Settlement at IX. 2.

III. CONCLUSION

For all of the foregoing reasons, California American Water recommends the Commission adopt the settlement agreements in this phase of the OII and reject the proposals of the Joint Consumers and the CFC; or, in the alternate, adopt the settlement agreements and defer consideration of these policy issues until the second phase of this proceeding.

September 17, 2007

Respectfully submitted,


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PROOF OF SERVICE

I, Michelle Chavez, declare as follows:

I am employed in the City and County of San Francisco, California. I am over the age of eighteen years and not a party to this action. My business address is STEEFEL, LEVITT & WEISS, One Embarcadero Center, 30th Floor, San Francisco, California 94111-3719. On September 17, 2007, I served the within:

Reply Brief of California-American Water Company on Phase 1A Issues

on the interested parties in this action addressed as follows:

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(BY MAIL) By placing such document(s) in a sealed envelope, with postage thereon fully prepaid for first class mail, for collection and mailing at Steefel, Levitt & Weiss, San Francisco, California following ordinary business practice. I am readily familiar with the practice at Steefel, Levitt & Weiss for collection and processing of correspondence for mailing with the United States Postal Service, said practice being that in the ordinary course of business, correspondence is deposited in the United States Postal Service the same day as it is placed for collection.

I declare under penalty of perjury under the laws of the State of California that the foregoing is true and correct and that this declaration was executed on September 17, 2007, at San Francisco, California.


Michelle Chavez

SERVICE LIST

I.07-01-022; A.06-09-006; A.06-10-026; A.06-11-009; A.06-11-010; A.07-03-019
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